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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER MAY 19 2006
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Reserve Bank Highlights Growth Prospects, Inflation Within Targets;
- Vehicle Exports Increase by 58%;
- Survey Shows Regulations Greatest Constraint to Business Expansion;
- Transnet and Unions Sign Restructuring Agreement;
- Koeberg's Unit 1 Operational;
- Business and Consumer Confidence Important; and
- Spending on Conditional Grants Examined.

End Summary.

Reserve Bank Highlights Growth Prospects, Inflation Within Targets

¶2. At the May 11th semiannual Monetary Policy Forum meeting, officials from the South African Reserve Bank (SARB) explained their reasons for leaving interest rates unchanged. The SARB's reasons included lowered inflation expectations since November 2005 and inflation remaining within the 3%-6% target range for 31 consecutive months. The SARB expects inflation to remain within its target range over the next several years. However, risks to inflation remain the same. Increasing current account deficits, rising oil prices, strong consumer demand and increasing household debt levels still worry the SARB as potential harbingers of accelerating inflation. According to SARB research, economic growth may accelerate to 5.1% if the government halves unemployment in 10 years, attracts another $804 million (R4.9 billion) a year in foreign direct investment and raises the savings rate to 22% of GDP. Currently, SARB research estimates growth with stable inflation at 4.1%. The South African government is targeting annual growth of 6% by 2010 to help reduce the official jobless rate of 26.7%, which is the highest of 61 countries tracked by Bloomberg. The SARB's latest quarterly inflation forecast showed that the targeted inflation rate, consumer prices without mortgage costs, should accelerate to just below 5% in the first quarter of 2007 and then remain slightly above the middle of the target range until the first quarter of 2008.
Source: Business Report, May 12.

Vehicle Exports Increase by 58%

¶3. According to the National Association of Automobile Manufacturers of SA (NAAMSA), new export contracts by major automobile manufacturers caused South African vehicle exports to grow by 58% in the first quarter 2006. Vehicle manufacturers such as Volkswagen SA, Toyota SA, Daimler Chrysler SA and Ford Southern Africa have multibillion rand export contracts, while General Motors SA (GMSA) has said it would make the country its main export base for its Hummer H3 vehicles. New vehicle exports increased from the fourth quarter 2005's level of 24,442 units to 38,541 units during the first quarter
¶2006. NAAMSA predicts that exports of vehicles should increase by 50% in 2006. During 2005, vehicle exports reached 140,000. Employment in the motor vehicle industry reached 36,184 during the first quarter 2006, 3% higher than the 4th quarter of 2005 and the highest aggregate level in the past 8.5 years. In the first quarter, sales for passenger vehicles increased 21% (y/y), while new commercial vehicle sales increased 24% (y/y). Over the past three years, prices of new cars (denominated in rands) have remained relatively stable. According to Wesbank, the average price of a new car in 2005 was R183,744 compared with the average price in 2002 of R185,037. Using the Automobile New Car Spend Index, over the past 15 years there had been only one spike in the average price of new vehicles between 2001 and 2002. Source: Business Day, May 16.

Survey Shows Regulations Greatest Constraint to Business Expansion
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¶4. For the second consecutive year, Grant Thornton's International Business Owners Survey (IBOS) showed that regulations were the greatest constraint to the expansion of business in South Africa. According to the survey, based on medium-sized businesses employing between 50 and 250 people, the proportion of people who cited this as the major constraint had risen to 45%, up from 41% in 2005. Small business owners reported varied experiences. Some cited complex black economic empowerment regulations and difficulties in registering businesses as examples of increased business costs due to regulation. The survey also found that 44% of business owners said that the lack of a skilled workforce posed a threat, up from 36% in
¶2005. The manufacturing sector is the most affected, with 51% of business owners citing regulation costs as a problem, while 48% cite a lack of skills as a major constraint to their business growth. Business growth in the wholesale and retail sectors is least affected by cost of regulations. Source: Business Report, May 16.

Transnet and Unions Sign Restructuring Agreement
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¶5. South Africa's Transnet has signed an agreement with four unions to guide the restructuring of the rail and logistics group, resolving a nine month dispute that caused a series of strikes. Under the agreement, Transnet will set time frames for the disposal of non-core businesses and consult unions on strategic and operational issues. Transnet plans to dispose of about R7.7 billion ($1.3 billion, using 6 rands per dollar) worth of non-core assets to achieve more focused management goals. The streamlining of Transnet is crucial to effective capital expenditure program of R40 billion over the next five years aimed at improving transportation infrastructure. Unions had been worried the restructuring process could cost 30,000 jobs. Both the government and Transnet have repeatedly stressed there would be no layoffs. The disposal of non-core assets does not include national

carrier South African Airways (SAA), which will remain government-owned, directly under the Department of Public Enterprises rather than Transnet's jurisdiction. Source: Reuters, May 17.

Koeberg's Unit 1 Operational

¶6. Unit One at Koeberg Power Station in the Western Cape was successfully returned to service after being out of commission for the past five months for repairs. The generator was damaged in December 2005, resulting in both the rotor and stator (upon which the rotor rotates) requiring repair. The stator was repaired at Koeberg, while a replacement rotor was obtained from the French utility, EdF. Eskom expects Koeberg Unit 1 to be operating at full power during the last week in May 2006. Koeberg Unit 2, however, will be shut down on 22 May as scheduled for refueling and maintenance, remaining offline through most of July. According to Eskom's Chief Executive Thulani Gcabshe, a shortfall of up to 400 MW may be experienced in the Western Cape during this period. Demand side management measures such as the issuing of five million Compact Fluorescent Lights (CFL's) to the Western Cape and the swapping out of two plate electric stoves for two plate gas stoves have begun to mitigate the shortage, and so far minimal load shedding has occurred. Source: I-Net Bridge, May 18.

Business and Consumer Confidence Important

¶7. Investec economists Brian Kantor and Carmen Marchetti view consumer confidence as more important in maintaining a country's high growth rather than indicators such as current account deficits or the level of household debt. They argue that if South African debt is compared to net wealth, the recent increases in debt levels become quite sustainable. In South Africa, net wealth as a percentage of disposable income has risen from 256% in 2002 to 374% in 2005. The Investec strategy report predicts that the household debt-to-income ratio will rise to above 70% over the next two years compared to 4th quarter's 65.5%. Confidence is a vital strategic asset and a lack of it has restrained growth in many economies in recent years,

including Japan's and several in Europe. High business and consumer confidence due to stable interest rates will lead to faster economic growth. Robust household spending will lead to higher capital inflows, which will help finance higher growth and maintain a relatively strong rand, providing a check to increasing domestic inflation. Source: Business Report, May 17.

Spending on Conditional Grants Examined

¶8. The Finance and Fiscal Commission found that the spending of conditional grants (grants designed to be spent for a specified purpose) at national and provincial levels was not properly monitored. The Commission examined several health conditional grants to illustrate conditional grant shortcomings. According to the Commission's findings, new conditional grants have been introduced without regard to their relationship to existing grants, with several uncoordinated grants serving the same purposes. In addition, the Commission's report pointed out that there were no pre-implementation plans and assessments that identified potential risks that might impede implementation, nor were there guidelines to mitigate such risks. Conditions for spending were not specified in detail and provinces were not required to meet minimum standards. The Commission asserted that misdirected spending of two conditional health grants worth R6.5 billion ($1.08 billion) undermined public

health goals and that these grants have not been independently reviewed since they began in 1998. The Commission's report claimed that public hospitals received only 52% of the funds necessary to provide a reasonable service. There were also 10.4% fewer hospital beds for the sick than there should have been. The Commission, set up under the constitution to advise the Treasury on the division of revenue between national, provincial and local governments, presented its recommendations for 2007-08 allocations to the National Council of Provinces. Source: Business Day and Business Report, May 16.

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